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RUEHSG/AMEMBASSY SANTIAGO 2080
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C O N F I D E N T I A L SECTION 01 OF 04 LA PAZ 000968

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TAGS: [ECON](#) [PGOV](#) [PREL](#) [ENRG](#) [EPET](#) [EINV](#) [BL](#) [EFIN](#) [PINR](#)
SUBJECT: BOLIVIAN GAS: PURGATORY

REF: A. LA PAZ 522
[1](#)B. 08 LA PAZ 1024

Classified By: A/EcoPol Chief Holly Monster for reasons 1.4 (b, d).

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Summary
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[1](#)1. (C) Over the past three years investments in the Bolivian gas fields have been minimal; this is changing, as companies have begun to make significant investments to guarantee enough gas for both domestic demand and exports to Brazil (with any excess going to Argentina). Moments of optimism that actual growth might also be possible have been tempered by the realities of dealing with the often irrational and incompetent Morales government. Petrobras will continue to lead the sector forward, but it is motivated as much by Brasilia's political concerns as by economic opportunities. Meanwhile, state control over much of the gas infrastructure is taking its toll and the recent decree obligating that any service contracts be offered to the state hydrocarbon company (YPFB) first not only violates the recently signed delivery agreements, but at the very least adds another bureaucratic hurdle to making investments. Neither heaven nor hell, Bolivia looks likely to keep the gas companies in purgatory for the near future (End Summary).

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Contracts Signed, Surprise Decree
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[1](#)2. (C) The gas production capacity in Bolivia remains around 40-42 million cubic meters per day (Mm3/d), where it has been relatively stable since the 2006 nationalization. Due to natural declines in well productivity however, the companies must now begin to make more substantial investments in field maintenance and new wells if production is to continue at the same level. Significant progress was made towards this goal, and the companies signed delivery agreements with the government in early June. Jaime Barenechea, North Area Manager (Bolivia/Northern Argentina)

for the U.S. service company Weatherford, told us that business has accelerated markedly this year as a backlog of field maintenance projects are finally being realized. Moreover, he estimated that four large drilling rigs would arrive in Bolivia over the next four years. No one is projecting a sizable jump in production, but there is general consensus that current levels will be maintained or possibly increased to the vicinity of 44-45 Mm3/d over the next five years.

13. (C) Optimism aside, the Morales Administration may well still defuse any positive momentum. By all accounts, company executives came out of a Friday meeting in early June with the Minister of Hydrocarbons Oscar Coca feeling positive about the assurances he gave them regarding the support necessary to make productive investments. The following Monday however, all were caught by surprise by a Presidential Decree mandating that any contracts for services or provision of equipment in the sector must first be offered to YPFB.

14. (C) The decree was likely a ploy to ensure that the three drilling rigs YPFB plans to bring to Bolivia are put to use, but someone in the ministry decided to expand the decree to include all services. (Note: The one rig that is already in Bolivia (Ref. a) is now inoperable. While attempting to drill for the Andina Company, the rig's electronic control systems burned up. No replacement parts were available. While on loan from Venezuela, the rig is of Chinese origin and parts have been requested from China. The two additional rigs that YPFB plans to import will also be Chinese. End

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note.) The decree violates provisions in the delivery agreements that dictate an open bidding process and all of the companies operating in Bolivia have sent protest letters to the government. According to Raul Kieffer, General Manager of the Bolivian Chamber of Hydrocarbons, both Chaco and Andina sent the most harshly critical letters. As both of these companies are now fully (Chaco) or majority (Andina) owned by the Bolivian state, Kieffer takes it as a positive sign that they will try to maintain technical autonomy. In Andina's case, it is also likely that after YPFB's first failed attempt at drilling for them, they do not want to have more YPFB services forced upon them.

15. (C) The biggest fear in the industry is that YPFB will admit they don't have the capacity to carry out a given service contract, but will use the decree to name a specific, politically connected service company to the contract. Petrobras Bolivia President Claudio Castejon said that even if it doesn't come to this, the decree will mean significant delays and yet more bureaucratic hassle. Currently he has 200 service contracts to bid out and does not cherish the idea of waiting for YPFB to process the bids and admit they don't have the capacity to carry out any of them.

YPFB Transport and Possible Further Nationalization

16. (C) YPFB Transport was born with the full nationalization of the principal pipeline operator (Transredes) in May, 2008. Technical staff and managers where all kept in place and there have been no major disruptions in service. That said, the nationalization is beginning to show some negative effects. Over the past year, YPFB Transport has had five different presidents. The current president, Cyro Camacho, was named after the former president publicly accused YPFB President Villegas of trying to run the company as his personal (and corrupt) fiefdom and was promptly fired. Camacho is widely praised in the industry and comes from a technical background within Transredes. Despite this, Keiffer reports that the Andean Development Corporation (CAF) has delayed loans to YPFB Transport because of the frequent turnover in leadership.

17. (C) In the field, the nationalization also appears to be having an effect. Roberto Dominguez, who covers Andina for minority owner Repsol, said that Andina detected a cracked pipe in one of its fields on a Friday afternoon. Only after much insistence did YPFB Transport send a team out to fix the pipe over the weekend. According to Dominguez such lax care of the infrastructure would not have happened under Transredes. Unfortunately, the risk of a serious mishap in the gas network is growing. Additionally, Jorge Kauer, the General Manager of Transierra, which operates the still private pipeline connecting the major southern field with the export pipeline to Brazil, thinks that President Morales is likely to nationalize his company before the end of the year. Transierra simply offers the easiest way to expand the network and increase the capability to export to Argentina.

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Petrobras: A Special Relationship with Bolivia
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18. (C) Petrobras always seems to get the worst deal out of any new regulations or tax structures put in place by the Bolivian government. The switch in rules to supply the domestic market perhaps hit the hardest (as Petrobras must supply some 70 percent of domestic demand at below cost (Ref.b), but a new tax law is also taking another bite out of their profit potential. Under the new delivery agreements, an additional tax must be paid to YPFB which most heavily penalizes operators of the established mega-fields, i.e.

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Petrobras. While operating in Bolivia is particularly difficult, company president Castejon told us he thought that Petrobras would remain in Bolivia for geopolitical reasons even if they were only breaking even financially.

19. (C) Currently Petrobras has four major areas of investment planned. In the San Alberto field they plan to spend \$200 million over 2-3 years to maintain production levels. In San Antonio, they will spend \$270 million over 3-4 years and attempt to increase productions by 50 percent. They are currently running an exploratory well in the new Ingre field, but two major set backs have pushed up the costs from \$33 to \$60 million. Finally, Petrobras hopes to become the operator in the Itau field (currently controlled by Total and British Gas), but is still waiting for permission from the Ministry of Hydrocarbons to alter the concession. All said, Petrobras continues to be the sector's biggest fish.

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Southern Pipeline Dreams
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10, (C) Despite dropping their demand for gas substantially at the start of the year, Brazil will continue to be Bolivia's principle market for gas until the end of the contract in 2019. That said, the potential of sending additional gas to Argentina is still a possibility. According to Jaime Barrenechea of Weatherford, several factors point towards greater future export volumes to the south. First, Barrenechea says that declining production in northern Argentina will free up room in the existing pipeline. Second, the Techint Group, based in Argentina, holds interests in the pipeline in Argentina, gas fields on the Bolivian side of the border (through subsidiary Tecpetrol), as well as several milling operations in Northern Argentina that are in dire need of additional gas. Barrenechea hypothesizes that there may well be enough private players on both sides of the border to make significant additional gas exports to Argentina a reality over the mid-term.

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Comment
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¶11. (C) Many paint the Bolivian economy in general and gas industry in particular as poised for a significant crash; they are not. Over the next one to two years, growth will not be dramatic, but neither will economic deceleration. The drop in commodity prices has hurt the economy and will be particularly acute for the remainder of the year as prices paid for gas to Brazil lags the market price by some six months, but Bolivia's historically high level of reserves and likely government spending leading towards the December elections will prop up the economy through 2009. Predictions for 2010 will largely depend on the world economy, but given the recovery in commodity prices and likely steady exports of natural gas, a sharp economic downturn is unlikely. The Bolivian economy appears only truly bad when compared to what might have been. No longer is construction of a gas separation facility likely, no longer do the private companies talk about production levels of 80 Mm3/d and higher, and no longer is Bolivia moving towards being the gas hub for South America. In a recent meeting with the Bolivian Country Representative for the Brazilian engineering firm Oderbrecht, Gustavo Assad ticked off four or five large engineering projects that were very promising in Bolivia: the hydroelectric system on the Madeira River (two dams are under construction in Brazil, none in Bolivia); the gas separation facility on the Brazilian export pipeline; the highway to the north which has promised financing from Brazil (and has gone nowhere since being announced by Lula last year); potential lithium mining in the Salar de Uyuni; and

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the Mutun mining project in Santa Cruz (which shows no signs of significant development any time soon). Despite the potential, Odebrecht currently has no projects in Bolivia. The economic cost of the Morales economic strategy will not likely be a dramatic collapse, but rather a drawn out period of stagnation: Welcome to purgatory.

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